Results of Operations

The following table sets forth certain statement of operations data as a percentage of total revenues for the periods indicated:

	Fiscal Years Ended April 30,		
	2007	2006 As restated	2005 As restated
Revenues			
Optical subsystems and components	91.1%	89.5%	86.0%
Network test and monitoring systems	8.9	10.5	14.0
Total revenues	100.0	100.0	100.0
Cost of revenues	64.6	68.7	73.7
Amortization of acquired developed technology	1.4	4.9	7.9
Impairment of acquired developed technology	—	0.2	1.3
Gross profit	34.0	26.2	17.1
Operating expenses:			
Research and development	15.4	14.9	22.9
Sales and marketing	8.6	9.1	10.8
General and administrative	8.5	8.5	8.4
Amortization of (benefit from) deferred stock compensation	—	—	0.1
Acquired in-process research and development	1.4	—	0.6
Amortization of purchased intangibles	0.4	0.5	0.4
Impairment of tangible assets	—	—	6.6
Restructuring costs	—	0.8	0.1
Other acquisition costs	—	—	—
Total operating expenses	34.3	33.8	49.9
Loss from operations	(0.4)	(7.6)	(32.8)
Interest income	1.5	0.9	0.9
Interest expense	(3.8)	(4.3)	(5.2)
Loss on convertible debt exchange	(7.6)	—	—
Other income (expense), net	(0.2)	2.6	(4.5)
Loss before income taxes and cumulative effect of change in accounting principle	(10.5)	(8.4)	(41.6)
Provision for income taxes	0.6	0.7	0.3
Loss before cumulative effect of change in accounting principle	(11.1)	(9.1)	(41.9)
Cumulative effect of adoption of accounting principle, net of tax	0.3	—	—
Net loss	(10.8)%	(9.1)%	(41.9)%

Comparison of Fiscal Years Ended April 30, 2007 and 2006

Revenues. Revenues increased $54.3 million, or 14.9%, to $418.5 million in fiscal 2007 compared to $364.3 million in fiscal 2006. Sales of optical subsystems and components and network test and monitoring systems represented 91.1% and 8.9%, respectively, of total revenues in fiscal 2007, compared to 89.5% and 10.5%, respectively, in fiscal 2006.

Optical subsystems and components revenues increased $55.3 million, or 17.0%, to $381.3 million in fiscal 2007 compared to $326.0 million in fiscal 2006. Of the total increase in optical subsystems and components

revenues, sales of products for short distance LAN/SAN applications increased $28.1 million, or 14.1%, and sales of products for MAN and telecom applications increased $27.2 million, or 21.5%. The increase in revenues from the sale of these products was primarily the result of an increase in the volume of units sold to new and existing customers.

Network test and monitoring systems revenues decreased $1.1 million, or 2.7%, to $37.3 million in fiscal 2007 compared to $38.3 million in fiscal 2006. The decrease in revenues was primarily due to a decrease in demand resulting from a product lifecycle transition as OEM system manufacturers complete their transition from 4Ghz to 6-8Ghz models.

Amortization of Acquired Developed Technology. Amortization of acquired developed technology, a component of cost of revenues, decreased $11.7 million, or 66.0%, in fiscal 2007 to $6.0 million compared to $17.7 million in fiscal 2006. The decrease reflects the impairment charges recorded in fiscal 2006 and 2005 as well as the roll-off of certain fully amortized assets during fiscal 2007.

Impairment of Acquired Developed Technology. Impairment of acquired developed technology, a component of cost of revenues, decreased from $853,000 in fiscal 2006 to $0 in fiscal 2007. The fiscal 2006 charges reflected the write off of technology for the linear optical amplifier product acquired with our acquisition of the assets of Genoa Corporation in April 2003 and technology related to the broadband lightsource product acquired with our acquisition of Transwave Fiber Inc., in May 2001. Each of these products was discontinued during the second quarter of fiscal 2006.

Gross Profit. Gross profit increased $46.7 million, or 48.8%, to $142.3 million in fiscal 2007 compared to $95.6 million in fiscal 2006. Gross profit as a percentage of total revenue was 34.0% in fiscal 2007 compared to 26.2% in fiscal 2006. We recorded reserve charges of $12.1 million for obsolete and excess inventory in fiscal 2007 and $9.3 million in fiscal 2006. We sold inventory that was reserved in previous periods resulting in a benefit of $4.1 million in fiscal 2007 and $3.6 million in fiscal 2006. As a result, we recognized a net non-cash reserve charge of $8.0 million in fiscal 2007 compared to $5.7 million in fiscal 2006. Manufacturing overhead includes non-cash stock-based compensation expense of $3.5 million in fiscal 2007 and $2.6 million in fiscal 2006. Excluding the amortization and impairment of acquired developed technology, the net impact of excess and obsolete inventory reserve charges and stock-based compensation expense, gross profit would have been $159.8 million, or 38.2% of revenue, in fiscal 2007, compared to $121.6 million, or 33.4% of revenue in fiscal 2006. The increase in adjusted gross profit margin was primarily due to the 14.9% increase in revenue driven by increases in unit volume with no increase in manufacturing spending coupled with decreases in material costs. Manufacturing overhead costs included duplicate manufacturing facility costs of $1.0 million in fiscal 2007 and $2.8 million in fiscal 2006 at our Advanced Optical Components Division as a result of our move to a new manufacturing facility in Texas, accelerated depreciation charges of $1.7 million in fiscal 2006 for abandoned leasehold improvements and equipment, and $1.3 million of severance related charges in fiscal 2006, all of which adversely impacted our gross profit margin.

Research and Development Expenses. Research and development expenses increased $10.1 million, or 18.6%, to $64.6 million in fiscal 2007 compared to $54.4 million in fiscal 2006. The increase was primarily due to increased personnel related spending, project materials and new product related scrap related to the development of new higher data rate transceiver products. Included in research and development expenses in fiscal 2006 were charges of $1.9 million related to abandoned leasehold improvements and equipment. Research and development expenses include non-cash stock-based compensation expense of $4.0 million in fiscal 2007 and $1.9 million in fiscal 2006. Research and development expenses as a percent of revenues increased to 15.4% in fiscal 2007 compared to 14.9% in fiscal 2006.

Sales and Marketing Expenses. Sales and marketing expenses increased $3.0 million, or 9.0%, to $36.1 million in fiscal 2007 compared to $33.1 million in fiscal 2006. The increase in sales and marketing expenses was primarily due to personnel related costs required to support our revenue growth. Sales and marketing expenses include non-cash stock-based compensation expense of $1.9 million in fiscal 2007 and $1.0 million in fiscal 2006. Sales and marketing expenses as a percent of revenues decreased to 8.6% in fiscal 2007 compared to 9.1% in fiscal 2006.

General and Administrative Expenses. General and administrative expenses increased $4.8 million, or 15.5%, to $35.6 million in fiscal 2007 compared to $30.9 million in fiscal 2006. The increase was primarily due to professional services expense of $5.5 million related to the investigation of our historical stock option granting practices. General and administrative expenses include non-cash stock-based compensation expense of $2.4 million in fiscal 2007 and $1.3 million in fiscal 2006. Also included in general and administrative costs in fiscal 2006 were accelerated depreciation charges of $130,000 related to abandoned equipment, accelerated amortization charges of $648,000 related to abandoned patents, and $237,000 for reduction in force. General and administrative expenses as a percent of revenues increased to 8.5% in fiscal 2007 compared to 8.5% in fiscal 2006.

Acquired In-process Research and Development. In-process research and development, or IPR&D, expenses were $5.8 million in fiscal 2007, compared to $0 in fiscal 2006. The fiscal 2007 IPR&D charges were related to the fourth quarter acquisitions of AZNA LLC and Kodeos Communications Inc.

Amortization of Purchased Intangibles. Amortization of purchased intangibles increased $67,000, or 3.8%, to $1.8 million in fiscal 2007 compared to $1.7 million in fiscal 2006. The slight increase was due to purchased intangibles related to our acquisitions of AZNA and Kodeos in the fourth quarter of fiscal 2007.

Restructuring Costs. During the second quarter of fiscal 2006, we completed the consolidation of our Northern California facilities. The restructuring charges included the remaining value of non-cancelable lease obligations of $2.8 million for our abandoned corporate office located in Sunnyvale and a portion of our facility in Scotts Valley and moving costs of $290,000.

Interest Income. Interest income increased $2.7 million, or 78.2%, to $6.2 million in fiscal 2007 compared to $3.5 million in fiscal 2006. The increase was primarily the result of increasing investment balances and rising interest rates during fiscal 2007.

Interest Expense. Interest expense increased $202,000, or 1.3%, to $16.0 million in fiscal 2007 compared to $15.8 million in fiscal 2006. Interest expense is primarily related to our convertible subordinated notes due in 2008 and 2010. Interest expense related to these notes was $13.8 million and $13.5 million in fiscal 2007 and 2006, respectively, of which, $4.8 million and $4.5 million respectively, represented the amortization of the beneficial conversion feature of these notes.. In fiscal 2007, $84,000 of interest expense was related to convertible promissory notes issued in connection with our acquisition of AZNA and the financing liability recorded as a result of the sale-leaseback of one of our corporate facilities. In fiscal 2006, $2.3 million of interest expense was related to convertible promissory notes issued in connection with our acquisitions of Data Transit and I-TECH, a minority investment in Cyoptics and a financing liability recorded as a result of the sale-leaseback of one of our corporate facilities. The principal and interest balances associated with the Data Transit, I-TECH and Cyoptics notes were converted into shares of our common stock in fiscal 2006.

Loss on Convertible Debt Exchange. In fiscal 2007, we exchanged $100 million of our 2 1/2% convertible subordinated notes due in 2010 for $100 million of new 2 1/2% convertible senior subordinated notes also due in 2010. Among other features, the new notes eliminated a put option that would have allowed the holders to require the redemption of the debt on October 15, 2007 for cash or shares. As a result of the exchange, we recorded a non-cash charge for the extinguishment of the original notes of $31.6 million in fiscal 2007.

Other Income (Expense), Net. Other income (expense), net, consisted of a net expense of $724,000 in fiscal 2007 compared to income of $9.3 million in fiscal 2006. In the third quarter of fiscal 2006, we recorded a gain of $11.0 million on the sale of a minority equity investment. Except for the gain in fiscal 2006, other expense primarily consists of non-cash amortization of subordinated loan costs.

Provision for Income Taxes. We recorded an income tax provision of $2.8 million for fiscal 2007 compared to $2.4 million for fiscal 2006. The income tax provision in fiscal 2007 and 2006 is primarily the result of establishing a deferred tax liability to reflect tax amortization of goodwill for which no book amortization has occurred. Due to the uncertainty regarding the timing and extent of our future profitability, we have recorded a valuation allowance to offset potential income tax benefits associated with our operating losses. As a result, we did not record any income tax benefit in either fiscal 2007 or 2006. There can be no assurance that deferred tax assets subject to the valuation allowance will ever be realized.

Cumulative effect of adoption of SFAS 123R. Upon the adoption of Statement of Financial Accounting Standards, or SFAS, 123R on May 1, 2006, we recorded an additional $1.2 million cumulative benefit from change in accounting principle, net of tax, reflecting the net cumulative impact of estimated forfeitures related to unvested stock options as of May 1, 2006 that were previously not included in the determination of historic stock-based compensation expense under APB 25 in periods prior to May 1, 2006.

Comparison of Fiscal Years Ended April 30, 2006 and 2005

Revenues. Revenues increased $83.5 million, or 29.7%, to $364.3 million in fiscal 2006 compared to $280.8 million in fiscal 2005. Sales of optical subsystems and components and network test and monitoring systems represented 89.5% and 10.5%, respectively, of total revenues in fiscal 2006, compared to 86.0% and 14.0%, respectively, in fiscal 2005.

Optical subsystems and components revenues increased $84.4 million, or 34.9%, to $326.0 million in fiscal 2006 compared to $241.6 million in fiscal 2005. Our acquisition on January 31, 2005, of certain assets of Infineon's fiber optics business unit contributed $26.1 million in revenues in fiscal 2006 compared to $4.9 million in fiscal 2005. Excluding the effect of the Infineon acquisition, sales of optical subsystems and components increased $63.2 million, or 26.7%, in fiscal 2006. Of the total increase in optical subsystems and components revenues of $84.4 million, sales of products for short distance LAN/SAN applications increased $57.7 million, or 40.0%, and sales of products for MAN and telecom applications increased $27.0 million, or 28.0%. The increase in revenues from the sale of these products was primarily the result of an increase in the volume of units sold to new and existing customers.

Network test and monitoring systems revenues decreased $904,000, or 2.3%, to $38.3 million in fiscal 2006 compared to $39.2 million in fiscal 2005. The decrease in revenues was primarily due to a decrease in demand resulting from a product lifecycle transition as OEM system manufacturers complete their transition from 2Ghz to 4Ghz models, partially offset by revenues related to acquired businesses.

Amortization of Acquired Developed Technology. Amortization of acquired developed technology, a component of cost of revenues, decreased $4.6 million, or 20.6%, in fiscal 2006 to $17.7 million compared to $22.3 million in fiscal 2005. The decrease reflects the impairment charges recorded in fiscal 2006 and 2005 as well as the roll-off of certain fully amortized assets during fiscal 2006.

Impairment of Acquired Developed Technology. Impairment of acquired developed technology, a component of cost of revenues, decreased $2.8 million, or 76.7%, in fiscal 2006 to $853,000 compared to $3.7 million in fiscal 2005. Included in the balances in fiscal 2006 was an impairment charge of $853,000 to write off technology for the linear optical amplifier product acquired with our acquisition of the assets of Genoa Corporation in April 2003 and technology related to the broadband lightsource product acquired with our acquisition of Transwave Fiber Inc., in May 2001. Each of these products was discontinued during the second quarter of fiscal 2006. Included in the balances for fiscal 2005 was an impairment charge of $3.7 million to write off the remaining book value of certain passive optical technology associated with our acquisition of assets of New Focus, Inc. in May 2002.

Gross Profit. Gross profit increased $47.5 million, or 98.9%, to $95.6 million in fiscal 2006 compared to $48.0 million in fiscal 2005. Gross profit as a percentage of total revenue was 26.2% in fiscal 2006 compared to 17.1% in fiscal 2005. We recorded charges of $9.3 million for obsolete and excess inventory in fiscal 2006 and $11.3 million in fiscal 2005. We sold inventory that was written-off in previous periods resulting in a benefit of $3.6 million in fiscal 2006 and $9.3 million in fiscal 2005. As a result, we recognized a net charge of $5.7 million in fiscal 2006 compared to $2.0 million in fiscal 2005. Manufacturing overhead includes non-cash stock-based compensation expense of $2.6 million in fiscal 2006 and $1.3 million in fiscal 2005. Excluding the amortization and impairment of acquired developed technology, the net impact of excess and obsolete inventory charges and stock-based compensation expense, gross profit would have been $122.4 million, or 33.6% of revenue, in fiscal 2006, compared to $77.2 million, or 27.5% of revenue in fiscal 2005. The increase in adjusted gross profit margin was primarily due to the 29.7% increase in revenue driven by increases in unit volume compared to an increase in manufacturing spending of 17.8% combined with decreases in material costs. Manufacturing overhead in fiscal 2006 included accelerated depreciation charges of $1.7 million for abandoned leasehold improvements and equipment and duplicate manufacturing facility costs of $2.8 million at our Advanced Optical Components

Division as a result of our move to a new manufacturing facility in Texas which adversely impacted our gross profit margin.

Research and Development Expenses. Research and development expenses decreased $9.8 million, or 15.3%, to $54.4 million in fiscal 2006 compared to $64.2 million in fiscal 2005. The decrease was primarily due to $5.5 million in reductions in spending for materials used to develop new products, $2.7 million in reductions in temporary labor and consulting services, and $913,000 in reductions in facility and corporate allocations as a result of corporate cost reductions. Research and development expense include non-cash stock-based compensation expense of $2.0 million in fiscal 2006 and $1.4 million in fiscal 2005. Also included in research and development expenses in fiscal 2006 were charges of $1.9 million related to abandoned leasehold improvements and equipment. Research and development expenses as a percent of revenues decreased to 14.9% in fiscal 2006 compared to 22.9% in fiscal 2005.

Sales and Marketing Expenses. Sales and marketing expenses increased $2.7 million, or 8.8%, to $33.1 million in fiscal 2006 compared to $30.5 million in fiscal 2005. The increase in sales and marketing expenses was primarily due to a $1.2 million increase in personnel-related costs and a $1.6 million increase in commission expense as a result of increased revenues, offset by reductions in marketing costs. Sales and marketing expense include non-cash stock-based compensation expense of $1.0 million in fiscal 2006 and $668,000 in fiscal 2005. Sales and marketing expenses as a percent of revenues decreased to 9.1% in fiscal 2006 compared to 10.8% in fiscal 2005.

General and Administrative Expenses. General and administrative expenses increased $7.2 million, or 30.3%, to $30.9 million in fiscal 2006 compared to $23.7 million in fiscal 2005. The increase was primarily due to an increase in legal expense of $2.5 million as a result of patent related litigation. Personnel related costs increased $1.7 million, including $237,000 for reduction in force related expenses, and our allowance for aged receivables based on a formula used to quantify receivables that might not be collectable increased $1.1 million primarily as a result of higher revenues, although actual bad debt write-offs were less than $100,000 in fiscal 2006. Also included in general and administrative costs in fiscal 2006 were accelerated depreciation charges of $130,000 related to abandoned equipment and accelerated amortization charges of $648,000 related to abandoned patents. General and administrative expenses include non-cash stock-based compensation expense of $1.3 million in fiscal 2006 and $308,000 in fiscal 2005. General and administrative expenses as a percent of revenues remained 8.5% in fiscal 2006 and 8.4% in fiscal 2005.

Amortization of (Benefit from) Deferred Stock Compensation. We recorded no expense for amortization of deferred stock compensation costs in fiscal 2006, compared to $162,000 in fiscal 2005. The benefit from deferred stock compensation is related to the termination of employees during a period with deferred compensation associated with their stock options and the effects of the graded vested method of amortization which accelerates the amortization of deferred compensation.

Acquired In-process Research and Development. In-process research and development, or IPR&D, expenses decreased $1.6 million, or 100%, to $0 in fiscal 2006 compared to $1.6 million in fiscal 2005. In fiscal 2005, $318,000 was related to the acquisition of Data Transit, $1.1 million was related to the acquisition of Infineon's optical transceiver products, and $114,000 was related to the acquisition of I-TECH.

Amortization of Purchased Intangibles. Amortization of purchased intangibles increased $643,000, or 58.2%, to $1.7 million in fiscal 2006 compared to $1.1 million in fiscal 2005. The increase was due to purchased intangibles related to our acquisitions of Infineon, I-Tech and InterSAN.

Impairment of Tangible Assets. During the quarter ended January 31, 2005, we recorded an impairment charge if $18.8 million to write down the carrying value of one of our corporate office facilities located in Sunnyvale, California upon entering into a sale-leaseback agreement. The property was written down to its appraised value, which was based on the work of an independent appraiser in conjunction with the sale-leaseback agreement. Due to our retention of an option to acquire the leased properties at fair value at the end of the fifth year of the lease, the sale-leaseback transaction was recorded in the fourth quarter of fiscal 2005 as a financing transaction under which the sale will not be recorded until the option expires or is otherwise terminated. At April 30, 2006, the carrying value of the financing liability, included in other long-term liabilities, was $12.0 million and the current portion of the financing liability, included in the current portion of long-term liabilities, was $297,000.

Restructuring Costs. During the second quarter of fiscal 2006, we completed the consolidation of our Northern California facilities. The restructuring charges included the remaining value of non-cancelable lease obligations of $2.8 million for our abandoned corporate office located in Sunnyvale and a portion of our facility in Scotts Valley and moving costs of $290,000. We recorded a restructuring charge of $287,000 in fiscal 2005 to adjust the operating lease liability for our Hayward facility that was closed in fiscal 2003.

Interest Income. Interest income increased $1.1 million, or 45.3%, to $3.5 million in fiscal 2006 compared to $2.4 million in fiscal 2005. The increase was primarily the result of increasing investment balances and rising interest rates during fiscal 2006.

Interest Expense. Interest expense increased $1.4 million, or 9.5%, to $15.8 million in fiscal 2006 compared to $14.5 million in fiscal 2005. Interest expense is primarily related to our convertible subordinated notes due in 2008 and 2010. Interest expense related to these notes was $13.5 million and $13.3 million, of which, $4.5 million and $4.3 million was the amortization of the beneficial conversion feature of these notes in fiscal 2006 and 2005, respectively. The increase in interest expense in fiscal 2006 was primarily related to notes associated with the acquisitions of Data Transit and I-TECH, a minority investment in Cyoptics and a financing liability recorded as a result of the sale-leaseback of one of our corporate facilities. The principal and interest balances associated with the Data Transit, I-TECH and Cyoptics notes were converted into shares of common stock in fiscal 2006.

Other Income (Expense), Net. Other income (expense), net, decreased $21.9 million, or 174.3%, to income of $9.3 million in fiscal 2006 compared to an expense of $12.6 million in fiscal 2005. In the third quarter of fiscal 2006, we recorded a gain on the sale of a minority equity investment of $11.0 million. In the fourth quarter of fiscal 2005, we recorded an impairment charge of $10.0 million to write-off a minority equity investment in a company. The remaining expense in fiscal 2006 and 2005 primarily consisted of our proportional share of losses associated with a minority investment and amortization of subordinated loan costs.

Provision for Income Taxes. We recorded an income tax provision of $2.4 million for fiscal 2006 compared to $856,000 for fiscal 2005. The income tax provision in fiscal 2006 and 2005 is primarily the result of establishing a deferred tax liability to reflect tax amortization of goodwill for which no book amortization has occurred. Due to the uncertainty regarding the timing and extent of our future profitability, we have recorded a valuation allowance to offset potential income tax benefits associated with our operating losses. As a result, we did not record any income tax benefit in either fiscal 2006 or 2005. There can be no assurance that deferred tax assets subject to the valuation allowance will ever be realized.

Liquidity and Capital Resources

At April 30, 2007, cash, cash equivalents and "available-for-sale" investments totaled $132.5 million compared to $118.8 million at April 30, 2006. Restricted securities, used to secure future interest payments on our convertible debt were $625,000 at April 30, 2007 compared to $5.5 million at April 30, 2006. At April 30, 2007, total short and long term debt was $267.6 million, compared to $247.8 million at April 30, 2006. The increase in debt during fiscal 2007 was primarily due to the issuance of convertible promissory notes in connection with our acquisition of AZNA.

Net cash provided by operating activities totaled $29.0 million in fiscal 2007, compared to cash used of $1.6 million in fiscal 2006 and $28.0 million in fiscal 2005. Cash provided by operating activities in fiscal 2007 was primarily a result of operating losses adjusted for non-cash related items. Working capital uses of cash in fiscal 2007 included cash inflows of $9.9 million offset by outflows of $22.3 million. Cash inflows were primarily due to a $3.8 million increase in accounts payable, a $2.4 million decrease in account receivable, and a $2.2 million increase in deferred income taxes. The increase in accounts payable was primarily due to increases in the dollar volume of payments as a result of increased unit volumes over the prior year and timing of payments. The decrease in accounts receivable was primarily due to the sale of receivables, partially offset by increase in revenues. The increase in deferred income taxes was primarily due to the book and tax differences associated with the amortization of goodwill related to certain asset acquisitions. Cash outflows were primarily due to an $17.4 million increase in inventories, a $6.2 million increase in other assets, and a $700,000 decrease in accrued compensation. The increases in inventories was due to increases in revenues and unit volume. The increase in other assets was primarily due to

investments in our patent portfolio. The decrease in accrued compensation was primarily due to lower commission accrual.

Net cash used in investing activities totaled $38.0 million in fiscal 2007, compared to cash provided by investing activities of $12.8 million in fiscal 2006, and cash used in investing activities of $27.9 million in fiscal 2005. Cash provided by investing activities in fiscal 2007 was $6.7 million, offset by cash used in investing activities of $44.7 million. Cash provided by investing activities in fiscal 2007 primarily consisted of maturity of restricted securities of $5.0 million and proceeds from the sale of property and equipment of $1.7 million. The use of cash in investing activities in fiscal 2007 was primarily related to our acquisitions of AZNA LLC and Kodeos Communications, Inc., purchases of equipment for our manufacturing facility in Malaysia to support increased production volumes and net purchases of short-term investments of $11.7 million. Cash provided by investing activities in fiscal 2006 primarily consisted of proceeds of $11.0 million received from the sale of a minority investment and net sales of short-term investments of $17.4 million. The use of cash in investing activities in fiscal 2006 was primarily due to purchases of equipment and facility improvements in Malaysia to support increased production volumes, the acquisition of InterSAN, Inc. and the acquisition of certain assets of Big Bear Networks.

Net cash provided by financing activities was $1.8 million in fiscal 2007, compared to $22.7 million in fiscal 2006 and $15.5 million in fiscal 2005. Cash provided by financing activities in fiscal 2007 primarily consisted of proceeds of $4.1 million from the exercise of employee stock options and purchases of stock under our employee stock purchase plan offset by repayments of an equipment loan by our bank. Cash provided by financing activities in fiscal 2006 primarily consisted of $9.9 million in proceeds from the equipment loan and proceeds of $14.0 million from the exercise of employee stock options and purchases of stock under our employee stock purchase plan. Cash provided by financing activities in fiscal 2005 included $12.9 million in proceeds from the sale-leaseback of one of our corporate offices and proceeds of $2.5 million from the exercise of stock options, offset by repayments of borrowings on our convertible notes.

We believe that our existing balances of cash, cash equivalents and short-term investments, together with the cash expected to be generated from our future operations, will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months. We may require additional financing to fund our operations in the future, including the repayment of our outstanding convertible subordinated notes. The volatility in the capital markets, particularly in the technology sector, may make it difficult for us to raise additional capital if and when it is required, especially if we experience disappointing operating results. If adequate capital is not available to us as required, or is not available on favorable terms, our business, financial condition and results of operations will be adversely affected.

At April 30, 2007, we had contractual obligations of $346.9 million as shown in the following table (in thousands):

		Payments Due by Period			
Contractual Obligations	**Total**	**Less Than 1 Year**	**1-3 Years**	**4-5 Years**	**After 5 Years**
Short-term debt	1,897	$ 1,897	$ —	$ —	$ —
Long-term debt	5,638	—	4,145	1,493	—
Convertible debt	267,200	66,950	100,250	100,000	—
Interest on debt	18,695	9,346	8,066	1,283	—
Lease commitment under sale-leaseback agreement	45,474	3,096	6,403	6,695	29,280
Operating leases	5,174	2,275	2,553	346	—
Purchase obligations	2,798	2,798	—	—	—
Total contractual obligations	$346,876	$ 86,362	$121,417	$109,817	$29,280

Short-term debt consists of $1.9 million representing the current portion of a note payable to a financial institution.

Long-term debt consists of the long-term portion of a note payable to a financial institution in the principal amount of $5.6 million.

Convertible debt consists of two series of convertible subordinated notes in the aggregate principal amount of $100.3 million due October 15, 2008, and $50.0 million due October 15, 2010 and a series of convertible senior subordinated notes in the aggregate principal amount of $100.0 million due October 15, 2010. The two series of convertible subordinated notes are convertible by the holders of the notes at any time prior to maturity into shares of Finisar common stock at specified conversion prices. The two series of notes are redeemable by us, in whole or in part, after October 15, 2004 and October 15, 2007, respectively. The convertible senior subordinated notes are convertible at the option of the holders, at any time on or prior to maturity, into shares of our common stock at a rate equal to approximately 305 shares of common stock per $1,000 principal of the notes, subject to adjustment in certain circumstances. However, the convertible senior subordinated notes contain provisions known as net share settlement which require that, upon conversion of the notes, we will pay holders in cash for up to the principal amount of the converted notes and that any amounts in excess of the cash amount will be settled in shares of our common stock. Annual interest payments on the convertible subordinated notes are approximately $9.0 million annually. Convertible notes also include two convertible promissory notes in the aggregate principal amount of approximately $17.0 million that were issued as in connection with the AZNA acquisition. The convertible promissory notes are payable, at our option, in cash or shares of our common stock.

Interest on debt consists of the scheduled interest payments on our short-term, long-term, and convertible debt.

The lease commitment under sale-leaseback agreement includes the principal amount of $12.0 million related to the sale-leaseback of our corporate office building, which we entered into in the fourth quarter of fiscal 2005.

Operating lease obligations consist primarily of base rents for facilities we occupy at various locations.

Purchase obligations consist of standby repurchase obligations and are related to materials purchased and held by subcontractors on our behalf to fulfill the subcontractors' purchase order obligations at their facilities. Our repurchase obligations of $2.8 million has been expensed and recorded on the balance sheet as non-cancelable purchase obligations as of April 30, 2007.

On November 1, 2007, the Company entered into an amended letter of credit reimbursement agreement with Silicon Valley Bank that will be available to the Company through October 26, 2008. The terms of the new amended agreement are substantially unchanged from the previous agreement, although, the bank has waived the SEC filing requirement covenant until the Company is current with its filing requirements. Under the terms of the amended agreement, Silicon Valley Bank is providing a $15 million letter of credit facility covering existing letters of credit issued by Silicon Valley Bank and any other letters of credit that may be required by us. Outstanding letters of credit secured by this agreement at April 30, 2007 totaled $11.3 million.

Off-Balance-Sheet Arrangements

At April 30, 2007 and April 30, 2006, we did not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Pending Adoption of New Accounting Standards

Fair Value Measurements

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements. SFAS 157 replaces the different definitions of fair value in the accounting literature with a single definition. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 is effective for fair-value measurements already required or permitted by other standards for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently in the process of

determining the impact of adopting the provisions of SFAS 157 on our financial position, results of operations and cash flows.

Fair Value Option for Financial Assets and Liabilities

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* , including an amendment of FASB Statement No. 115 (FAS 159). FAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The provisions of FAS 159 become effective for fiscal years beginning after November 15, 2007. We believe that the adoption of SFAS 159 will not have a material effect on our financial statements.

Accounting for Electronic Equipment Waste Obligations

In June 2005, the FASB issued FSP No. FAS 143-1, *Accounting for Electronic Equipment Waste Obligations* ("FSP 143-1"). FSP 143-1 provides guidance in accounting for obligations associated with Directive 2002/96/EC (the "Directive") on Waste Electrical and Electronic Equipment adopted by the European Union. FAS 143-1 is required to be applied to the later of the first reporting period ending after June 6, 2005 or the date of the Directive's adoption into law by the applicable EU member countries in which we have significant operations. The Directive distinguishes between "new" and "historical" waste. New waste relates to products put on the market after August 13, 2005. FSP 143-1 directs commercial users to apply the provisions of FASB Statement No. 143, Accounting for Asset Retirement Obligations, and the related FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations, for the measurement and recognition of the liability and asset retirement obligation associated with the historical waste management requirements of the Directive. Additionally, FSP 143-1 provides guidance for the accounting by producers for the financing of the obligations of historical waste held by private households.

We adopted FAS 143-1 in the first quarter of fiscal 2006 and concluded that no significant liability had been incurred as of April 30, 2006. We believe that the adoption of FSP 143-1 will not have a material effect on our financial statements.

Accounting for Income Taxes

In June 2006, the FASB issued Interpretation, or FIN, No. 48, *Accounting for Uncertainty in Income Taxes — an Interpretation of SFAS No. 109,* or FIN 48. FIN 48 clarifies the accounting for uncertain taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes.* FIN 48 prescribes a recognition threshold and measurement of a tax position taken or expected to be taken in an enterprise's tax return. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure related to uncertain income tax positions. FIN 48 is effective for the fiscal years beginning after December 15, 2006 for all public companies. Accordingly, we were required to adopt FIN 48 as of May 1, 2007. The adoption of FIN 48 will not have a material impact on our consolidated financial statements.

Item 7A. *Quantitative and Qualitative Disclosures About Market Risk*

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. We place our investments with high credit issuers in short-term securities with maturities ranging from overnight up to 36 months or have characteristics of such short-term investments. The average maturity of the portfolio will not exceed 18 months. The portfolio includes only marketable securities with active secondary or resale markets to ensure portfolio liquidity. We have no investments denominated in foreign country currencies and therefore our investments are not subject to foreign exchange risk.

We invest in equity instruments of privately-held companies for business and strategic purposes. These investments are included in other long-term assets and are accounted for under the cost method when our ownership interest is less than 20% and we do not have the ability to exercise significant influence. For entities in which we hold greater than a 20% ownership interest, or where we have the ability to exercise significant influence, we use the equity method. We recorded losses of $237,000 in fiscal 2007, $2.1 million in fiscal 2006, and $1.8 million in fiscal 2005, for investments accounted for under the equity method. For these non-quoted investments, our policy is to regularly

review the assumptions underlying the operating performance and cash flow forecasts in assessing the carrying values. We identify and record impairment losses when events and circumstances indicate that such assets are impaired. There were no impairment losses on these assets during fiscal 2007 or 2006. We recognized impairment on these assets of $10.0 million in fiscal 2005. If our investment in a privately-held company becomes marketable equity securities upon the company's completion of an initial public offering or its acquisition by another company, our investment would be subject to significant fluctuations in fair market value due to the volatility of the stock market.

The following table summarizes the expected maturity, average interest rate and fair market value of the available-for-sale debt securities held by us (and related receivables) and debt securities issued by us as of April 30, 2007 (in thousands):

	Fiscal Years Ended April 30,				Fair
	2008	2009	2010 and Thereafter	Total Cost	Market Value
Assets					
Available-for-sale debt securities	$68,078	$ 8,182	$ 2,510	$ 78,770	$ 78,670
Average interest rate	3.09%	4.36%	5.20%		
Restricted securities	$ 625	$ —	$ —	$ 625	$ 625
Average interest rate	0.00%				
Liabilities					
Long-term debt:					
Fixed rate	$ —	$100,250	$ —	$100,250	$ 99,248
Average interest rate		5.25%			
Fixed rate	$ —	$ —	$ 50,000	$ 50,000	$ 61,970
Average interest rate			2.50%		
Fixed rate	$ —	$ —	$100,000	$100,000	$123,941
Average interest rate			2.50%		

The following table summarizes the expected maturity, average interest rate and fair market value of the available-for-sale debt securities held by us (and related receivables) and debt securities issued by us as of April 30, 2006 (in thousands):

	Fiscal Years Ended April 30,				Fair
	2007	2008	2009 and Thereafter	Total Cost	Market Value
Assets					
Available-for-sale debt securities	$51,972	$16,490	$ 5,714	$ 74,176	$ 73,600
Average interest rate	2.65%	4.14%	4.38%		
Restricted securities	$ 3,705	$ 1,815	$ —	$ 5,520	$ 5,415
Average interest rate	2.24%	2.60%			
Liabilities					
Long-term debt:					
Fixed rate	$ —	$ —	$100,250	$100,250	$218,727
Average interest rate			5.25%		
Fixed rate	$ —	$ —	$150,000	$150,000	$104,260
Average interest rate			2.50%		

We have subsidiaries located in China, Malaysia, Europe and Singapore. Due to the relative volume of transactions through these subsidiaries, we do not believe that we have significant exposure to foreign currency exchange risks. We currently do not use derivative financial instruments to mitigate this exposure. In July 2005, China and Malaysia changed the system by which the value of their currencies are determined. Both currencies moved from a fixed rate pegged to the U.S. dollar to a managed float pegged to a basket of currencies. We expect that this will have a minor negative impact on our future costs. We continue to review this issue and may consider hedging certain foreign exchange risks through the use of currency forwards or options in future years.

Item 8. ***Financial Statements and Supplementary Data***

FINISAR CORPORATION CONSOLIDATED FINANCIAL STATEMENTS INDEX

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Finisar Corporation

We have audited the accompanying consolidated balance sheets of Finisar Corporation as of April 30, 2007 and April 30, 2006 (restated), and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended April 30, 2007 (2006 and 2005, restated). Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Finisar Corporation at April 30, 2007 and 2006 (restated), and the consolidated results of its operations and its cash flows for each of the three years in the period ended April 30, 2007 (2006 and 2005, restated), in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, the Company has restated its previously issued financial statements as of April 30, 2006 and for the years ended April 30, 2006 and 2005 to correct for errors in share-based compensation and related tax effects.

As discussed in Note 3 to the consolidated financial statements, on May 1, 2006 the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123R, *Share-Based Payment*, using the modified-prospective-transition method.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Finisar Corporation's internal control over financial reporting as of April 30, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated December 3, 2007 expressed an unqualified opinion thereon

/s/ Ernst & Young LLP

San Jose, California
December 3, 2007

FINISAR CORPORATION

CONSOLIDATED BALANCE SHEETS

	April 30, 2007	April 30, 2006 (As restated) (note 2)
	(In thousands except per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 56,106	$ 63,361
Short-term investments	56,511	33,507
Restricted investments, short-term	625	3,705
Accounts receivable, net of allowance for doubtful accounts of $1,607 and $2,198 at April 30, 2007 and 2006	55,969	57,388
Accounts receivable, other	7,752	8,963
Inventories	77,670	53,570
Prepaid expenses	4,553	4,112
Total current assets	259,186	224,606
Long-term investments	19,855	21,918
Property, plant and improvements, net	84,071	82,225
Restricted investments, long-term	—	1,815
Purchased technology, net	18,351	14,972
Other purchased intangible assets, net	5,647	4,184
Goodwill, net	128,949	124,532
Minority investments	11,250	15,093
Other assets	19,363	17,125
Total assets	$ 546,672	$ 506,470
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 40,187	$ 34,221
Accrued compensation	10,550	10,932
Other accrued liabilities	12,590	13,129
Deferred revenue	5,473	5,070
Current portion of other long-term liabilities	2,255	2,333
Convertible notes	66,950	—
Non-cancelable purchase obligations	2,798	1,209
Total current liabilities	140,803	66,894
Long-term liabilities:		
Convertible notes, net of beneficial conversion feature of $7,184 and $11,975 at April 30, 2007 and 2006	193,066	238,275
Other long-term liabilities	21,042	21,253
Deferred income taxes	6,090	3,919
Total long-term liabilities	220,198	263,447
Commitments and contingent liabilities		
Stockholders' equity:		
Preferred stock, $0.001 par value, 5,000,000 shares authorized, no shares issued and outstanding at April 30, 2007 and 2006		
Common stock, $0.001 par value, 750,000,000 shares authorized, 308,632,366 shares issued and outstanding at April 30, 2007 and 305,512,111 shares issued and outstanding at April 30, 2006	309	306
Additional paid-in capital	1,529,322	1,487,464
Deferred stock compensation	—	(3,616)
Accumulated other comprehensive income	11,162	1,698
Accumulated deficit	(1,355,122)	(1,309,723)
Total stockholders' equity	185,671	176,129
Total liabilities and stockholders' equity	$ 546,672	$ 506,470

See accompanying notes.

FINISAR CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

	Fiscal Years Ended April 30,		
	2007	2006 (As restated) (note 2)	2005 (As restated) (note 2)
	(In thousands, except per share data)		
Revenues			
Optical subsystems and components	$381,263	$ 325,956	$ 241,582
Network test and monitoring systems	37,285	38,337	39,241
Total revenues	418,548	364,293	280,823
Cost of revenues	270,272	250,186	206,836
Amortization of acquired developed technology	6,002	17,671	22,268
Impairment of acquired developed technology	—	853	3,656
Gross profit	142,274	95,583	48,063
Operating expenses:			
Research and development	64,559	54,412	64,232
Sales and marketing	36,122	33,144	30,456
General and administrative	35,641	30,864	23,684
Amortization of deferred stock compensation	—	—	162
Acquired in-process research and development	5,770	—	1,558
Amortization of purchased intangibles	1,814	1,747	1,104
Impairment of tangible assets	—	—	18,798
Restructuring costs	—	3,064	287
Total operating expenses	143,906	123,231	140,281
Loss from operations	(1,632)	(27,648)	(92,218)
Interest income	6,204	3,482	2,396
Interest expense	(16,044)	(15,842)	(14,468)
Loss on convertible debt exchange	(31,606)	—	—
Other income (expense), net	(724)	9,346	(12,582)
Loss before income taxes and cumulative effect of change in accounting principle	(43,802)	(30,662)	(116,872)
Provision for income taxes	2,810	2,367	856
Loss before cumulative effect of change in accounting principle	(46,612)	(33,029)	(117,728)
Cumulative effect of accounting change in accounting principle, net of taxes	(1,213)	—	—
Net loss	$ (45,399)	$ (33,029)	$ (117,728)
Net loss per share — basic and diluted:			
Before cumulative effect of change in accounting principle	$ (0.15)	$ (0.11)	$ (0.51)
Cumulative effect of accounting change in accounting principle	$ 0.00	$ —	$ —
Net loss per share — basic and diluted	$ (0.15)	$ (0.11)	$ (0.51)
Shares used in computing net loss per share — basic and diluted	307,804	290,518	232,210

See accompanying notes.

Table of Contents

FINISAR CORPORATION

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Notes Receivable from Stockholders	Deferred Stock Compensation	Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity
				(In thousands, except share data)				
Balance at April 30, 2004, as previously reported	**222,531,335**	**$ 222**	**$ 1,259,759**	**$ (481)**	**$ (162)**	**$ 710**	**$ (1,057,203)**	**$ 202,845**
Cumulative effect of restatement (see note 2)		—	112,309		(10,384)		(101,763)	162
Balance at April 30, 2004, restated (note 2)	**222,531,335**	**222**	**1,372,068**	**(481)**	**(10,546)**	**710**	**(1,158,966)**	**203,007**
Stock-based compensation expense related to Note 2	—	—	(2,120)	—	5,738	—	—	3,618
Issuance of common stock for completion of milestones related to acquisition of Transwave	144,806	—	256	—	—	—	—	256
Issuance of common stock related to acquisition of certain assets	34,000,000	34	52,462	—	—	—	—	52,496
Exercise of warrants, stock options, net of repurchase of unvested shares	1,654,422	2	1,452	14	—	—	—	1,468
Issuance of common stock through employee stock purchase plan	600,715	1	1,015	—	—	—	—	1,016
Payments received on stockholder notes receivable	—	—	—	467	—	—	—	467
Unrealized gain (loss) on available-for-sale investments	—	—	—	—	—	(465)	—	(465)
Foreign currency translation adjustment	—	—	—	—	—	136	—	136
Net loss	—	—	—	—	—	—	(117,728)	(117,728)
Comprehensive loss								(118,057)
Balance at April 30, 2005, restated (note 2)	**258,931,278**	**$ 259**	**$ 1,425,133**	**—**	**$ (4,808)**	**$ 381**	**$ (1,276,694)**	**$ 144,271**
Stock-based compensation expense related to Note 2			6,111		1,192			7,303
Issuance of common stock of conversion of convertible notes	28,785,022	$ 29	33,476	—	—	—	—	33,505
Issuance of common stock related to acquisition of InterSan	7,132,229	7	8,809	—	—	—	—	8,816
Exercise of warrants, stock options, net of repurchase of unvested shares	9,434,333	10	12,849	—	—	—	—	12,859
Issuance of common stock through employee stock purchase plan	1,229,249	1	1,086	—	—	—	—	1,087
Unrealized gain (loss) on available-for-sale investments	—	—	—	—	—	(80)	—	(80)
Foreign currency translation adjustment	—	—	—	—	—	1,397	—	1,397
Net loss	—	—	—	—	—	—	(33,029)	(33,029)
Comprehensive loss								(31,712)
Balance at April 30, 2006, restated (note 2)	**305,512,111**	**$ 306**	**$ 1,487,464**	**—**	**$ (3,616)**	**$ 1,698**	**$ (1,309,723)**	**$ 176,129**
Stock-based compensation expense related to Note 2			(3,616)		3,616			—
Exercise of warrants, stock options, net of repurchase of unvested shares	2,260,837	2	3,637	—	—	—	—	3,639
Issuance of common stock through employee stock purchase plan	860,025	1	1,680	—	—	—	—	1,681
Stock-based compensation expense related to employee stock options and employee stock purchases	—	—	11,637	—	—	—	—	11,637
Beneficial conversion on issuance of debt	—	—	29,733	—	—	—	—	29,733
Cumulative effect of change in accounting principle	—	—	(1,213)	—	—	—	—	(1,213)
Unrealized gain on available-for-sale investments	—	—	—	—	—	5,645	—	5,645
Foreign currency translation adjustment	—	—	—	—	—	3,819	—	3,819
Net loss	—	—	—	—	—	—	(45,399)	(45,399)
Comprehensive loss								(35,935)
Balance at April 30, 2007	**308,632,973**	**$ 309**	**$ 1,529,322**	**—**	**—**	**$ 11,162**	**$ (1,355,122)**	**$ 185,671**

See accompanying notes.

USB FIN 002093

Table of Contents

FINISAR CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Fiscal Years Ended April 30,		
	2007	2006 As Restated (Note 2)	2005 As Restated (Note 2)
		(In thousands)	
Operating activities			
Net loss	$ (45,399)	$ (33,029)	$ (117,728)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	26,893	33,467	28,841
Compensation expense related to modification of existing options	—	—	16
Stock-based compensation expense	11,822	6,819	3,838
Acquired in-process research and development	5,770	—	1,558
Amortization of beneficial conversion feature of convertible notes	4,791	4,527	4,256
Amortization of purchased technology and other purchased intangibles	1,814	1,747	1,103
Amortization of acquired developed technology	6,002	17,672	22,269
Amortization of discount on restricted securities	(92)	(160)	(244)
Loss (gain) on sale of equipment	1,214	(153)	1,174
Gain on sale of minority investment	(1,198)	(10,967)	—
Loss on extinguishment of debt	31,606	—	—
Loss on retirement of assets	—	—	329
Share of losses of equity investee	237	2,118	1,766
Impairment of minority investments	—	—	10,000
Impairment of intangible assets	—	853	3,656
Impairment of assets	—	—	18,798
Changes in operating assets and liabilities:			
Accounts receivable	2,449	(14,683)	(13,290)
Inventories	(17,364)	(18,651)	3,455
Other assets	(6,230)	(5,288)	(5,266)
Deferred income taxes	2,176	2,287	1,632
Accounts payable	3,768	3,537	970
Accrued compensation	(737)	6,230	69
Other accrued liabilities	1,375	596	1,911
Deferred revenue	114	1,525	2,899
Net cash provided by (used in) operating activities	29,011	(1,553)	(27,988)
Investing activities			
Purchases of property, equipment and improvements	(22,340)	(22,887)	(21,202)
Purchases of short and long-term investments	(164,796)	(245,916)	(177,642)
Sale/maturity of short and long-term investments	153,141	263,344	177,776
Maturity of restricted securities	4,951	3,750	6,381
Acquisition of subsidiaries, net of cash assumed	(10,708)	(1,213)	694
Acquisition of product line assets	—	3,868	(13,694)
Proceeds from sale of property and equipment	512	914	743
Proceeds from sale of minority investment	1,198	10,967	—
Purchases of, and loan to, minority investments, net of loan repayments	—	—	(1,000)
Net cash provided by (used in) investing activities	(38,042)	12,827	(27,944)
Financing activities			
Proceeds from the issuance of a note	—	9,897	—
Financing liability related to sale-leaseback of building	—	—	12,900
Repayments of liability related to sale-leaseback of building	(296)	(243)	(360)
Repayments of borrowings under notes	(2,036)	(944)	—
Payment received on stockholder notes receivable	—	—	467
Proceeds from exercise of stock options and stock purchase plan, net of repurchase of unvested shares	4,108	13,946	2,484
Net cash provided by financing activities	1,776	22,656	15,491
Net increase (decrease) in cash and cash equivalents	(7,255)	33,930	(40,441)
Cash and cash equivalents at beginning of year	63,361	29,431	69,872
Cash and cash equivalents at end of year	$ 56,106	$ 63,361	$ 29,431
Supplemental disclosure of cash flow information			
Cash paid for interest	$ 9,514	$ 9,449	$ 9,013
Cash paid for taxes	$ 659	$ 40	$ 42
Supplemental schedule of non-cash investing and financing activities			
Issuance of convertible promissory note on asset purchase	$ —	$ —	$ 16,270
Issuance of convertible promissory note on acquisition of subsidiary	$ 16,950	$ —	$ 12,061
Issuance of convertible promissory note for minority investment	$ —	$ —	$ 3,750
Issuance of common stock and warrants and assumption of options in connection with acquisitions	$ —	$ 8,816	$ 52,752
Issuance of common stock upon conversion of promissory note	$ —	$ 33,505	$ —

FINISAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Description of Business

Finisar Corporation is a leading provider of optical subsystems and components that connect local area networks, or LANs, storage area networks, or SANs, and metropolitan area networks, or MANs. Our optical subsystems consist primarily of transceivers which provide the fundamental optical-electrical interface for connecting the equipment used in building these networks. These products rely on the use of digital semiconductor lasers in conjunction with integrated circuit design and novel packaging technology to provide a cost-effective means for transmitting and receiving digital signals over fiber optic cable using a wide range of network protocols, transmission speeds and physical configurations over distances of 70 meters to 200 kilometers. Our line of optical components consists primarily of packaged lasers and photodetectors used in transceivers, primarily for LAN and SAN applications. Our manufacturing operations are vertically integrated and include internal manufacturing, assembly and test capability. We sell our optical subsystem and component products to manufacturers of storage and networking equipment such as Brocade, Cisco Systems, EMC, Emulex, Hewlett-Packard Company, Huawei, and Qlogic.

We also provide network performance test and monitoring systems primarily to leading storage equipment manufacturers such as Brocade, EMC, Emulex, Hewlett-Packard Company, and Qlogic for testing and validating equipment designs and, to a lesser degree, to operators of networking and storage data centers for testing, monitoring and troubleshooting the performance of their installed systems.

Finisar Corporation was incorporated in California in April 1987 and reincorporated in Delaware in November 1999. Finisar's principal executive offices are located at 1389 Moffett Park Drive, Sunnyvale, California 94089, and its telephone number at that location is (408) 548-1000.

2. Restatement of Consolidated Financial Statements

The Audit Committee of the Board of Directors ("Audit Committee") has completed a review of the Company's stock option granting practices and accounting. Based on the results of this review, the Company concluded that the accounting measurement dates under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), for certain stock option grants awarded made from the date of the Company's initial public offering on November 11, 1999 through September 30, 2006 (the "Review Period") differ from the measurement dates previously used to determine any share-based compensation expense during the seven fiscal years ended April 30, 2006. The Company is restating its consolidated balance sheet as of April 30, 2006 and the related consolidated statements of operations, stockholders' equity, and cash flows for the fiscal years ended April 30, 2006 and 2005 as a result of the Company's review of information developed through the independent investigation of the Company's historical stock option grants. In addition, the Company is restating the share-based compensation expense that the Company discussed in its footnotes under the fair value method as presented in Note 16, "Stockholders' Equity", and the unaudited quarterly financial information and financial statements for the interim period ended July 30, 2006 and all interim periods of fiscal 2006 in Note 27, "Quarterly Financial Data (Unaudited)", of this report.

Background of the Audit Committee Investigation

In late August 2006, management commenced a preliminary internal review of certain of the Company's historical stock options granted since the Company's initial public offering on November 11, 1999. The review was voluntarily initiated by us due to widespread media attention concerning the stock option grant practices of many companies and was not in response to a news report or an investigation concerning Finisar by the Securities and Exchange Commission or any other governmental agency. After management's report on the results of this initial review, the Audit Committee directed management to conduct a further analysis of certain stock option grants. Thereafter, management reviewed documentation and materials regarding additional option grants and, in early

FINISAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

November, identified potential issues with respect to certain annual grants to employees. As a result, the Audit Committee determined that it should undertake a more comprehensive investigation of our historical practices for granting and accounting for stock options during the Review Period. On November 30, 2006, the Company issued a press release and filed a Current Report on Form 8-K announcing the commencement of this review of its historical stock option granting practices and related accounting, and disclosing that the Company's previously-filed financial statements could no longer be relied upon. The Company also informed the staff of the Securities and Exchange Commission of the commencement of the investigation into its historical stock option granting practices and related accounting. The Audit Committee's investigation was conducted with the assistance of independent counsel and forensic accountants.

The scope of the Audit Committee's investigation was extensive, and included the review of all stock option grants during the Review Period . In addition, the investigation involved testing and analyses of the Company's hiring, termination, leave of absence, and grant notification practices regarding stock options during the Review Period.

Findings

Based on the results of the investigation, the Company found evidence that it previously used incorrect measurement dates when accounting for stock option grants pursuant to Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* , or APB 25, and related interpretations. The Company concluded that revised measurement dates are required for approximately 71% of the stock option grants awarded during the Review Period. Revising option grant measurement dates resulted in total additional stock-based compensation charges of $107.6 million to be recognized in the fiscal years 2000 through 2006. Approximately 85% of this total additional stock-based compensation expense, or $91.1 million, is attributable to six key Granting Actions that occurred between June 2000 and August 2003, representing approximately 21 million shares, or 20% of all options granted during the Review Period. Three of these six key Granting Actions were performance grants, and three were New Hire grants, as such grant types are defined below. The Audit Committee determined that the incorrect measurement dates were the result of process-related deficiencies and that the individuals involved in the option granting process reached a thorough understanding of the relevant accounting rules. The Audit Committee found no evidence of intentional misconduct or malfeasance on the part of the Company personnel involved in selecting and approving the grant dates or administering the stock option granting process.

The reasons for the revised measurement dates varied with the particular facts and circumstances of each affected grant, including: grants that were not approved until after the stated grant date; grants that were dated and priced at a time when lists of grant recipients and share allocations were not yet finalized; grants that were not accurately and timely documented; grant dates that appeared to have been selected retrospectively, in some cases apparently due to price considerations; and grants that were completed and subsequently modified.

In addition, the Company identified modifications to certain stock options related to extended leaves of absence that should have been accounted for by applying modification accounting as required by the provisions of FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation,* or FIN 44. This resulted in $5.1 million of additional stock-based compensation expense, of which $4.9 million is attributable to one leave of absence. Therefore, as a result of the investigation, the Company identified a total of $112.1 million in additional pre-tax, non-cash, stock-based compensation charges for the fiscal years 2000 through 2006 ($112.7 million prior to the consideration of payroll tax charges and inventory capitalization) and had approximately $3.6 million of deferred stock-based compensation expense to be amortized as of April 30, 2006. On May 1, 2006, we adopted Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), *"Share-Based Payment"* ("SFAS 123R"). As required by SFAS 123R, the unamortized deferred compensation expense of $3.6 million at May 1, 2006 has been reclassified to additional paid-in capital.

FINISAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

With respect to grants that the Company determined had been completed and later repriced, the Company applied variable accounting in accordance with APB 25 and FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25* ("FIN 44").

Restatement of Financial Statements

Following the conclusion of the Audit Committee's investigation, with the concurrence of management, the Company determined that it should have recognized approximately $112.1 million of pre-tax share-based compensation expense during the Review Period that was not accounted for in the Company's previously issued financial statements. In addition, the Company should have recorded approximately $1.6 million of payroll tax expense. Therefore, the Company is restating financial information in this report for the fiscal years ended as of April 30, 2006 and for the fiscal years ended April 30, 2006 and 2005.

To reflect this previously unrecognized non-cash expense the Company has recognized additional share-based compensation expense and payroll tax expense, that has the overall effect of increasing the accumulated deficit, and common stock and additional paid-in capital. The table below reflects the impact, by year, of the restatement:

	Restatement Adjustments						
Fiscal Year Ended	Gross Stock-Based Compensation Charge	Stock-Based Compensation Capitalized to Inventory	Net Stock-Based Compensation Charge	Payroll Tax Charge	Total Pre-Tax Charges	Income Tax (Benefit) Provision	After-Tax Non-Cash Charge
	(In thousands)						
April 30, 2000	$ 5,416	$ (124)	$ 5,292	$ 0	$ 5,292	$ (2,112)	$ 3,180
April 30, 2001	27,160	(563)	26,597	175	26,772	(10,906)	15,866
April 30, 2002	31,780	(568)	31,212	22	31,234	13,018	44,252
April 30, 2003	24,482	835	25,317	3	25,320	—	25,320
April 30, 2004	13,087	72	13,159	(14)	13,145	—	13,145
Cumulative Effect at April 30, 2004	101,925	(348)	101,577	186	101,763	—	101,763
April 30, 2005	3,440	236	3,676	(55)	3,621	—	3,621
April 30, 2006	7,303	(484)	6,819	1,425	8,244	(134)	8,110
Total	$ 112,668	$ (596)	$ 112,072	$1,556	$113,628	$ (134)	$113,494

The cumulative effect of share-based compensation pre-tax adjustments was to increase additional paid-in capital by $112.3 million and to increase accumulated deficit by $101.8 million on the Company's consolidated balance sheet as of April 30, 2004. The restatement had no impact on the Company's previously reported cash flows or revenues.

FINISAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following tables are detailed restated financial statements for the April 30, 2006 consolidated balance sheet and consolidated statements of operations and consolidated statements of cash flows for the years ended April 30 2006 and 2005.

Consolidated Balance Sheet Impact

The following table reconciles the Company's consolidated balance sheet as previously reported to the as restated amounts as of April 30, 2006:

CONSOLIDATED BALANCE SHEET

	April 30, 2006		
	As Previously Reported	Adjustments	As Restated
		(In thousands)	
ASSETS			
Current assets:			
Cash and cash equivalents	$ 63,361	$ —	$ 63,361
Short-term investments	33,507	—	33,507
Restricted investments, short-term	3,705	—	3,705
Accounts receivable, net of allowances	57,388	—	57,388
Accounts receivable, other	8,963	—	8,963
Inventories	52,974	596	53,570
Prepaid expenses	4,112	—	4,112
Total current assets	224,010	596	224,606
Long-term investments	21,918	—	21,918
Property, plant and improvements, net	82,225	—	82,225
Restricted investments, long-term	1,815	—	1,815
Purchased technology, net	14,972	—	14,972
Other purchased intangible assets, net	4,184	—	4,184
Goodwill, net	124,532	—	124,532
Minority investments	15,093	—	15,093
Other assets	17,125	—	17,125
Total assets	$ 505,874	$ 596	$ 506,470
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	$ 34,221	$ —	$ 34,221
Accrued compensation	9,376	1,556	10,932
Other accrued liabilities	13,129	—	13,129
Deferred revenue	5,070	—	5,070
Current portion of other long-term liabilities	2,333	—	2,333
Non-cancelable purchase obligations	1,209	—	1,209
Total current liabilities	65,338	1,556	66,894
Long-term liabilities:			
Convertible notes	238,275	—	238,275
Other long-term liabilities	21,253	—	21,253
Deferred income taxes	4,053	(134)	3,919
Total long-term liabilities	263,581	(134)	263,447
Stockholders' equity:			
Preferred stock	—	—	—
Common stock	306	—	306
Additional paid-in capital	1,371,180	116,284	1,487,464
Deferred stock compensation	—	(3,616)	(3,616)
Accumulated other comprehensive income	1,698	—	1,698
Accumulated deficit	(1,196,229)	(113,494)	(1,309,723)
Total stockholders' equity	176,955	(826)	176,129
Total liabilities and stockholders' equity	$ 505,874	$ 596	$ 506,470

FINISAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Consolidated Statements of Operations Impact

The following table reconciles the Company's consolidated statements of operations as previously reported to the as restated amounts for the years ended April 30, 2006 and 2005:

	Fiscal Years Ended April 30,					
	2006			2005		
	As Previously Reported	Adjustment	As Restated	As Previously Reported	Adjustment	As Restated
	(In thousands, except per share data)					
Statement of Operations Data:						
Revenues						
Optical subsystems and components	$ 325,956	$ —	$325,956	$ 241,582	$ —	$ 241,582
Network test and monitoring systems	38,337	—	38,337	39,241	—	39,241
Total revenues	364,293	—	364,293	280,823	—	280,823
Cost of revenues	247,126	3,060	250,186	205,631	1,205	206,836
Amortization of acquired developed technology	17,671	—	17,671	22,268	—	22,268
Impairment of acquired developed technology	853	—	853	3,656	—	3,656
Gross profit (loss)	98,643	(3,060)	95,583	49,268	(1,205)	48,063
Operating expenses:						
Research and development	51,903	2,509	54,412	62,799	1,433	64,232
Sales and marketing	31,925	1,219	33,144	29,783	673	30,456
General and administrative	29,408	1,456	30,864	23,374	310	23,684
Amortization of (benefit from) deferred stock compensation	—	—	—	162	—	162
Acquired in-process research and development	—	—	—	1,558	—	1,558
Amortization of purchased intangibles	1,747	—	1,747	1,104	—	1,104
Impairment of tangible assets	—	—	—	18,798	—	18,798
Restructuring costs	3,064	—	3,064	287	—	287
Total operating expenses	118,047	5,184	123,231	137,865	2,416	140,281
Loss from operations	(19,404)	(8,244)	(27,648)	(88,597)	(3,621)	(92,218)
Interest income	3,482	—	3,482	2,396	—	2,396
Interest expense	(15,842)	—	(15,842)	(14,468)	—	(14,468)
Other income (expense), net	9,346	—	9,346	(12,582)	—	(12,582)
Loss before income taxes	(22,418)	(8,244)	(30,662)	(113,251)	(3,621)	(116,872)
Provision for income taxes	2,501	(134)	2,367	856	—	856
Net loss	$ (24,919)	$ (8,110)	$ (33,029)	$(114,107)	$ (3,621)	$(117,728)
Net loss per share — basic and diluted:	(0.09)	(0.03)	(0.11)	(0.49)	(0.02)	(0.51)
Shares used in computing net loss per share — basic and diluted	290,518	290,518	290,518	232,210	232,210	232,210

FINISAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Consolidated Statements of Cash Flows Impact

The following table reconciles the Company's consolidated statements of cash flows as previously reported to the restated amounts for the years ended April 30 2006 and 2005:

	2006			2005		
	As Previously Reported	Adjustment	As Restated	As Previously Reported	Adjustment	As Restated
	(In thousands)					
Operating activities						
Net loss	$ (24,919)	$ (8,110)	$ (33,029)	$(114,107)	$ (3,621)	$(117,728)
Adjustments to reconcile net loss to net cash used in operating activities:						
Depreciation and amortization	33,467		33,467	28,841		28,841
Compensation expense related to modification of existing options	—		—	16		16
Stock-based compensation expense related to employee stock options and employee stock purchases	—		—	—		—
Amortization of deferred stock compensation	—	6,819	6,819	162	3,676	3,838
Acquired in-process research and development	—		—	1,558		1,558
Amortization of beneficial conversion feature of convertible notes	4,527		4,527	4,256		4,256
Amortization of purchased technology and other purchased intangibles	1,747		1,747	1,103		1,103
Amortization of acquired developed technology	17,672		17,672	22,269		22,269
Amortization of discount on restricted securities	(160)		(160)	(244)		(244)
Loss (gain) on sale of equipment	(153)		(153)	1,174		1,174
Gain on sale of minority investment	(10,967)		(10,967)	—		—
Loss on retirement of assets	—		—	329		329
Share of losses of equity investee	2,118		2,118	1,766		1,766
Impairment of minority investments	—		—	10,000		10,000
Impairment of intangible assets	853		853	3,656		3,656
Impairment of assets	—		—	18,798		18,798
Changes in operating assets and liabilities:						
Accounts receivable	(14,683)		(14,683)	(13,290)		(13,290)
Inventories	(18,651)		(18,651)	3,455		3,455
Other assets	(5,288)		(5,288)	(5,266)		(5,266)
Deferred income taxes	2,421	(134)	2,287	1,632		1,632
Accounts payable	3,537		3,537	970		970
Accrued compensation	4,805	1,425	6,230	124	(55)	69
Other accrued liabilities	596		596	1,911		1,911
Deferred revenue	1,525		1,525	2,899		2,899
Net cash used in operating activities	(1,553)	—	(1,553)	(27,988)	—	(27,988)
Investing activities						
Purchases of property, equipment and improvements	(22,887)		(22,887)	(21,202)		(21,202)
Purchases of short and long-term investments	(245,916)		(245,916)	(177,642)		(177,642)
Sale/maturity of short and long-term investments	263,344		263,344	177,776		177,776
Maturity of restricted securities	3,750		3,750	6,381		6,381
Acquisition of subsidiaries, net of cash assumed	(1,213)		(1,213)	694		694
Acquisition of product line assets	3,868		3,868	(13,694)		(13,694)
Proceeds from sale of property and equipment	914		914	743		743
Proceeds from sale of minority investment	10,967		10,967	—		—
Purchases of, and loan to, minority investments, net of loan repayments	—		—	(1,000)		(1,000)
Net cash provided by (used in) investing activities	12,827	—	12,827	(27,944)	—	(27,944)
Financing activities						
Proceeds from the issuance of a note	9,897		9,897	—		—
Financing liability related to sale-leaseback of building	—		—	12,900		12,900
Repayments of liability related to sale-leaseback of building	(243)		(243)	(360)		(360)
Repayments of borrowings under notes	(944)		(944)	—		—
Payment received on stockholder notes receivable	—		—	467		467
Proceeds from exercise of stock options and stock purchase plan, net of repurchase of unvested shares	13,946		13,946	2,484		2,484
Proceeds from issuance of convertible debt, net of issue costs	—		—	—		—
Net cash provided by financing activities	22,656	—	22,656	15,491	—	15,491
Net increase (decrease) in cash and cash equivalents	33,930	—	33,930	(40,441)	—	(40,441)
Cash and cash equivalents at beginning of year	29,431	—	29,431	69,872	—	69,872
Cash and cash equivalents at end of year	$ 63,361	$ —	$ 63,361	$ 29,431	$ —	$ 29,431

FINISAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Consolidated Statement of Stockholders' Equity Impact

The cumulative effect of the restatement on stockholders' equity as of April 30, 2004, and the restatement amounts for the years ended April 30, 2006 and 2005, are provided in the Consolidated Statement of Stockholders' Equity in the accompanying Consolidated Financial Statements.

SFAS 123 Disclosure Impact

As a consequence of the stock option adjustments discussed above, the pro forma stock-based compensation expense under the fair value method has been restated. The Company has applied APB 25 and its related interpretations and provided the required pro forma disclosures under SFAS 123 and its related interpretations through the fiscal year ended April 30, 2006. For SFAS 123 pro forma disclosure purposes, stock-based compensation expense determined under the fair value method was adjusted to include the incremental expense resulting from the modification to the measurement dates of the affected options. During the investigation the Company also identified and corrected errors in certain valuation assumptions used in the Black-Scholes model to estimate the fair value of option grants under SFAS 123 in fiscal years prior to 2004. A table illustrating the impact of the components above is presented in footnote 16 of this report.

The following table presents the effect of the related adjustments on the pro forma calculation of the net loss and net loss per share for the years ended April 30, 2006 and 2005, respectively:

	Fiscal Years Ended April 30,					
	2006			2005		
	As Previously Reported	Adjustment	As Restated	As Previously Reported	Adjustment	As Restated
	(In thousands, except per share amounts)					
Net loss	$(24,919)	$ (8,110)	$(33,029)	$(114,107)	$ (3,621)	$(117,728)
Add:						
APB 25 stock-based compensation expense, included in net loss, net of tax	—	6,819	6,819	162	3,676	3,838
Less:						
Stock-based compensation expense determined under fair value based method, net of tax	(10,241)	185	(10,056)	(20,360)	2,680	(17,680)
Pro forma net loss	$(35,160)	$ (1,106)	$(36,266)	$(134,305)	$ 2,735	$ (13,570)
Net loss per share — basic and diluted:						
As reported	$ (0.09)	$ (0.02)	$ (0.11)	$ (0.49)	$ (0.02)	$ (0.51)
Pro forma	$ (0.12)	$ 0.00	$ (0.12)	$ (0.58)	$ 0.01	$ (0.57)
Shares used in computing reported and pro forma net loss — basic and diluted	290,518	290,518	290,518	232,210	232,210	232,210

FINISAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

3. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

These consolidated financial statements include the accounts of Finisar Corporation and its wholly-owned subsidiaries (collectively "Finisar" or the "Company"). Intercompany accounts and transactions have been eliminated in consolidation.

Fiscal Periods

The Company maintains its financial records on the basis of a fiscal year ending on April 30, with fiscal quarters ending on the Sunday closest to the end of the period (thirteen-week periods). The first three quarters of fiscal 2007 ended on July 30, 2006, October 29, 2006, and January 28, 2007. The first three quarters of fiscal 2006 ended on July 31, 2005, October 30, 2005 and January 29, 2006, respectively. The first three quarters of fiscal 2005 ended on August 1, 2004, October 31, 2004 and January 30, 2005, respectively.

Reclassifications

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation. These changes had no impact on previously reported net income or retained earnings.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Revenue Recognition

The Company's revenue transactions consist predominately of sales of products to customers. The Company follows the Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104 *Revenue Recognition* and Emerging Issues Task Force ("EITF") Issue 00-21 *Revenue Arrangements with Multiple Deliverables*. Specifically, the Company recognizes revenue when persuasive evidence of an arrangement exists, title and risk of loss have passed to the customer, generally upon shipment, the price is fixed or determinable, and collectability is reasonably assured. For those arrangements with multiple elements, or in related arrangements with the same customer, the arrangement is divided into separate units of accounting if certain criteria are met, including whether the delivered item has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. The consideration received is allocated among the separate units of accounting based on their respective fair values, and the applicable revenue recognition criteria are applied to each of the separate units. In cases where there is objective and reliable evidence of the fair value of the undelivered item in an arrangement but no such evidence for the delivered item, the residual method is used to allocate the arrangement consideration. For units of accounting which include more than one deliverable, the Company generally recognizes all revenue and cost of revenue for the unit of accounting over the period in which the last undelivered item is delivered.

At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses associated with sales, recorded as a component of cost of revenues. The Company's customers and distributors generally do not have return rights. However, the Company has established an allowance for estimated customer returns, based on historical experience, which is netted against revenue.

Sales to certain distributors are made under agreements providing distributor price adjustments and rights of return under certain circumstances. Revenue and costs relating to distributor sales are deferred until products are sold by the distributors to end customers. Revenue recognition depends on notification from the distributor that

product has been sold to the end customer. Also reported by the distributor are product resale price, quantity and end customer shipment information, as well as inventory on hand. Deferred revenue on shipments to distributors reflects the effects of distributor price adjustments and, the amount of gross margin expected to be realized when distributors sell-through products purchased from us. Accounts receivable from distributors are recognized and inventory is relieved when title to inventories transfers, typically upon shipment from us at which point we have a legally enforceable right to collection under normal payment terms.

Segment Reporting

Statement of Financial Accounting Standards (SFAS) No. 131 *Disclosures about Segments of an Enterprise and Related Information* establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. SFAS 131 also establishes standards for related disclosures about products and services, geographic areas and major customers. The Company has determined that it operates in two segments consisting of optical subsystems and components and network test and monitoring systems.

Concentrations of Credit Risk

Financial instruments which potentially subject Finisar to concentrations of credit risk include cash, cash equivalents, short-term, long-term and restricted investments and accounts receivable. Finisar places its cash, cash equivalents and short-term, long-term and restricted investments with high-credit quality financial institutions. Such investments are generally in excess of Federal Deposit Insurance Corporation (FDIC) insurance limits. Concentrations of credit risk, with respect to accounts receivable, exist to the extent of amounts presented in the financial statements. Generally, Finisar does not require collateral or other security to support customer receivables. Finisar performs periodic credit evaluations of its customers and maintains an allowance for potential credit losses based on historical experience and other information available to management. Losses to date have been within management's expectations. The Company's five largest customers represented 33.3% and 34.7% of total accounts receivable at April 30, 2007 and 2006. One optical subsystems and components customer, Jabil Circuit, represented 15.8% of total accounts receivable at April 30, 2007 and another optical subsystems and components customer, Cisco Systems, represented 8.7% of total accounts receivable at April 30, 2006.

Current Vulnerabilities Due to Certain Concentrations

Finisar sells products primarily to customers located in North America. During fiscal 2007, 2006 and 2005, sales of optical subsystems and components to Cisco Systems represented 20.8%, 22.3% and 27.8%, respectively, of total revenues. No other customer accounted for more than 10% of total revenues in any of these fiscal years.

Included in the Company's consolidated balance sheet at April 30, 2007, are the net assets of the Company's manufacturing operations, substantially all of which are located in Malaysia and which total approximately $62.3 million.

Foreign Currency Translation

The functional currency of our foreign subsidiaries is the local currency. Assets and liabilities denominated in foreign currencies are translated using the exchange rate on the balance sheet dates. Revenues and expenses are translated using average exchange rates prevailing during the year. Any translation adjustments resulting from this process are shown separately as a component of accumulated other comprehensive income. Foreign currency transaction gains and losses are included in the determination of net loss.

Research and Development

Research and development expenditures are charged to operations as incurred.